BICA Accountant's Week

'Impact of the Current Financial Crisis on the Direction of the Securities Commission'

Presentation by Philip Stubbs

Chairman

November 10, 2008

British Colonial Hilton
Nassau, Bahamas

Good afternoon ladies and gentlemen. I would like to thank the Bahamas Institute of Chartered Accountants for inviting me to speak at this event and for providing me the opportunity to discuss the current international financial crisis, how it is impacting the domestic and international components of our local capital markets, and how the Securities Commission of The Bahamas intends to address any challenges. However, before I begin, I must use the Commission's standard disclaimer: that the views expressed in this speech are my own and may not represent those of the Securities Commission, its members or staff. I should also advise, in the interest of full disclosure, that as a member of BICA this is also an opportunity for me make up some of my continuing education hours without having to attend any of these sessions as a result of the time spent in preparing and giving this presentation.

You would have heard from the earlier presentation by the Inspector of Banks and Trust Companies, Mr. Stanley Bereza, a summary of the genesis of the sub-prime mortgage crisis and the current global financial meltdown. There is no utility to this gathering to indulge you in a similar exercise; rather, I will make an effort to explain how the global financial meltdown has impacted the Bahamian economy and capital markets.

We are all familiar with the structure of the Bahamian economy and its dependence on tourism and financial services. And, most of you will also be aware of the importance of the exchange control regime that operates in The Bahamas. The Exchange Control Regulations that are administered by the Central Bank of The Bahamas through its Exchange Control Department requires that: (i)

Bahamians desirous of acquiring foreign assets must either secure foreign exchange through the investment currency market or obtain approval from the Central Bank; and (ii) Non-Bahamians desirous of purchasing Bahamian assets must seek approval from the Central Bank.

This exchange control regime, by imposing restrictions on local Bahamian entities accessing international capital markets, has essentially ring-fenced the local financial and capital markets from a direct impact of the global financial crisis. However, as we have seen over the past months, our local capital markets are impacted by the effect the global crisis has had on the real sectors of the Bahamian economy. How has this happened? Volatility in the international markets has reduced investor and consumer confidence and resulted in depreciated stock prices and a fall in production in the advanced economies. This has had the effect of increased unemployment and a reduction in disposable incomes in these jurisdictions causing a reduction in the demand for goods and services, including tourism and financial services, by residents in these developed economies. The fall in activities in critical sectors of the Bahamian economy, particularly tourism, has resulted in a reduction of GDP, increased unemployment, and an erosion of investor confidence that has seen the BISX All Share Index lose substantial value over the past months. The first two quarters of this year have seen excessive declines in the Index with only a slight increase in the third quarter. In comparison to last year, this represents an 11.8% decline for the first two quarters and a small gain of 0.7% during the third quarter. It is estimated that BISX-listed companies have lost over $400M in their values since the beginning of the year.

The meltdown has the potential to further erode consumer and investor confidence if the current trend in tourism persists. For example, tourism arrivals have contracted 2.2% (some 53,000 fewer visitors) over the first half of this year compared to the same period last year. Workers in the tourism sector are experiencing fewer work days per week as well as being laid off. This has serious multiplier impact on the rest of the economy, which if it persists, could result in debt obligations of persons affected not being serviced and creating a strain on the banking sector.

The Domestic Capital Markets

The Bahamian capital markets consist of both local and offshore (international) financial activities. The local capital markets consist primarily of traditional capital market products such as equities, traded on BISX or over-the-counter; corporate debt of listed companies, government treasury bills and registered stock, administered by the Central Bank; and investment funds. Derivatives and securities-backed obligations are virtually non-existent in the local market. The local offshore capital market is dominated by investment fund administration and management, and asset management activities that engage in, have direct exposure to, and for all practical purposes are an integral component of the international financial market.

It would be remiss of me not to note the recent relaxation in the exchange control regime by the Central Bank to allow resident investors (including individuals and institutions) to invest in international securities, subject to limits against the Bank's external reserves. This translates into consideration by the Central Bank for controlled access to foreign capital markets by Bahamians with relationships with domestic broker-dealers. This has facilitated exposure to investments in subprime securities or their derivatives. The segment of the market that has accessed the Central Bank facility could be considered to have the most direct exposure to these investments. Three funds have taken advantage of the noted facility. Indications are that these funds have experienced returns ranging from -12.42% to 0.24% over the one year period ending September 30th.

The local offshore or international component of the capital markets in The Bahamas has been adversely affected by the international financial meltdown. Investment fund administrators authorized by the Commission have reported falling NAVs as a consequence of exposure to sub-prime mortgages and the fallout resulting from the global meltdown, which include increased net redemptions as a result of erosion of investor confidence. Market participants have further reported falling revenues as a result of the shrinking assets under management.

Role of the Regulator

The primary responsibility of the Commission is to protect the interest of the investing public, and this is reflected in the provisions of the legislation that it is statutorily responsible for administering. These include the Securities Industries Act, 1999; the Investment Funds Act, 2003; and the Financial and Corporate Service Providers Act, 2000. Under the Securities Industry Act, the mandate of the Commission is to:

1. Formulate principles to regulate and govern mutual funds, securities and capital markets;
2. Maintain surveillance over mutual funds, securities and capital markets ensuring orderly, fair and equitable dealings;
3. Create and promote conditions to ensure the orderly growth and development of capital markets;
4. Advise the Minister of Finance regarding investment funds, securities and capital markets.

In carrying out its mandate, the specific functions of the Commission encompass the authorisation of market participants and of products that are being offered to the public.

In protecting the investing public the Commission has to ensure that persons operating in the industry are fit and proper, adhere to good corporate governance principles, are not co-mingling accounts of clients with operating accounts, that issuers of securities are providing information on material changes to their entities in a timely fashion to ensure that there are no opportunities for insider trading or manipulation of the market, and to ensure that consumers are in a position to make informed decisions about their investments.

In a financial crisis it is imperative that the Commission is in a position to supervise the industry, in a vigilant manner, to ensure that these things are in fact being adhered to. The Commission has to ensure that the investing public has confidence in its regulatory oversight to enhance the development of the industry. I mentioned to you earlier that current market developments have caused a decline in revenues for some market participants. In a situation like this the Commission will be very vigilant; the Commission will be attentive in ensuring that client resources are not used to fund operations.

It is also appropriate to mention here that the Commission expects to enhance its regulatory capabilities through the implementation of a new Securities Industries Act, and related Regulations, and by the implementation of recommendations from a recently-completed operations review of the Commission. Measures will include:

1. A more extensive use of regulations for matters that require more frequent updating.
2. Formally making investor protection as one of the Commission's functions.
3. A risk assessment of the financial services industry including an assessment of its comparative advantages.
4. Reviewing, adopting and strict enforcement of financial resource requirements for broker/dealers to ensure adequate regulatory capital and liquidity.
5. Inspections that will increase focus on corporate governance and risk management; also continued improvement of the execution of joint

inspections now carried out with the Supervision Department of the Central Bank.

6. More robust provisions and enforcement of corporate governance of regulated entities; for segregation of client accounts; and notification of specified events.

In addition to the ongoing regulation of the industry by the Commission, the market events discussed earlier today in this and other presentations point to the need for increased focus on certain accounting and financial reporting issues. Both the Commission and the accounting profession (specifically through BICA) are required to provide guidance and advice to participants in the capital markets to ensure that investors and the public are properly informed during these uncertain and challenging times. Indeed there is no reason why some of these initiatives should not be collaborative efforts.

Information disclosed in the annual reports of public companies and public-sector entities should indicate clearly and adequately:

1. Strategies and risk assessments focusing on the implications of various current and potential economic scenarios.
2. The impact of liquidity on business strategy and financial condition.
3. Discussion of critical accounting estimates and how they are arrived at.
4. The entity's ability to continue as a going concern.

Some aspects of this information may already be required as part of the financial statement presentation and disclosure; however other information and analysis presented by management should ensure that these issues are fully and clearly outlined.

Other accounting considerations include:

1. Careful use of fair value measures for complex or illiquid securities.
2. Proper revenue recognition.
3. Careful review of Impairment of assets.

Auditors and regulators must also raise questions about what is happening in an industry and how management is preparing for what lies ahead. Issues addressed should include all of the matters previously cited, as well as matters of corporate governance and compliance with regulatory requirements.

Conclusion

The global financial crisis has directly impacted the local economy and has indirectly impacted its capital markets. The Commission is quite aware of the situation and is doing all within its means to ensure the interest of the investing public is protected, and the reputation of the jurisdiction as an international financial centre is maintained. This can only be accomplished through vigorous supervision of the industry and the application of professional standards and ethics by the service providers (including accountants and auditors).

I thank you once again for this opportunity and extend best wishes for the success of the remaining activities of Accountants' week.

Thank you and good afternoon.